April 20, 2006

Ms. Mary Rupp
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Supervisory Committee Audits

Dear Ms. Rupp:

The purpose of this letter is to provide responses to NCUA's request for comments on the proposed changes of Rule 715 (Supervisory Committee Audits). As stated in the request, NCUA seeks public comment in the form of answers to the following issues: (A) whether to require credit unions to obtain an "attestation on internal controls" in connection with their annual audits; (B) what standards should govern the assessment and attestation components of such an engagement; (C) what qualifications should be required as prerequisites to serve on a Supervisory Committee; (D) what standard should dictate the degree of independence required of state-licensed, compensated auditors; and (E) miscellaneous issues involving audit options for credit unions having less than $500 million in assets, requirements for delivery and regulatory access to audit reports, and the terms and conditions in engagement letters, including limitations on auditor liability. Accordingly, we offer the following responses to your list of questions:

Whether to require credit unions to obtain an "attestation on internal controls" in connection with their annual audits:

1. **Question** – Should part 715 require, in addition to a financial statement audit, an "attestation on internal controls" over financial reporting above a certain minimum asset size threshold? Explain why or why not.

   Response – In addition to a financial statement audit, credit unions above an established minimum asset size threshold should be required to obtain an attestation on internal controls over financial reporting. The basis for this position is to ensure that credit unions maintain the public's trust and demonstrate a strong commitment to sound financial practices and reporting. While it is true that credit unions are not subject to many of the influences faced by publicly traded companies (i.e., generally those driving or driven by stock price), credit unions must be mindful of and dedicated to sound business practices which in turn will help maintain public support for the credit union movement. A compelling argument against requiring credit unions to obtain an attestation on internal control is cost vs. benefit. Therefore, NCUA should set a minimum threshold for requiring the attestation.

2. **Question** – What minimum asset size threshold would be appropriate for requiring, in addition to a financial statement audit, an "attestation on internal controls" over financial reporting, given the additional burden on management and its external auditor? Explain the reason for the threshold you favor.

   Response – As of December 31, 2004, CUNA reported each of the largest 99 credit unions in terms of total assets to be in excess of $1 billion. In the event an attestation on internal controls becomes a requirement, all credit unions with assets of $1 billion or more should be required to obtain an attestation on internal controls. Setting the threshold for obtaining an attestation on internal controls at the $1 billion mark would be consistent with the requirement of non-public banks and would alleviate most credit unions from this requirement. Since the one percent of credit unions with total assets in excess of $1 billion represents 34% of the total assets of credit unions (CUNA 12/31/04), requiring the attestation of this group of large credit unions should provide the necessary risk coverage to safeguard the underlying insurance system and the credit union members it is designed to protect without requiring attestation of those credit unions under $1 billion.

3. **Question** – Should the minimum asset size threshold for requiring an "attestation on internal controls" over financial reporting be the same for natural person credit unions and corporate credit unions? Explain why.

   Response – If implemented, the minimum asset size threshold for requiring an attestation on internal controls over financial reporting should be the same for both natural person credit unions and corporate credit unions even though both types of institutions have inherent risk that are unique to their business.

4. **Question** – Should management's assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting, (i.e., financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes), or should it be more narrowly framed to cover only certain types of financial reporting? If so, which types?

   Response – Management's assessments should cover all financial reporting (i.e., regulatory, audited, etc.). Excluding certain type financial reporting from coverage could be confusing or misleading to the users of such information.

5. **Question** – Should the same auditor be permitted to perform both the financial statement audit and the "attestation on internal controls" over financial reporting, or should a credit union be allowed to engage one auditor to perform the financial statement audit and another to perform the "attestation on internal controls?" Explain the reasons for your answer.

   Response – Credit unions should be permitted to make this determination based on the circumstances unique to their institution. Having the same auditor perform both the financial statement audit and the attestation on internal controls over financial reporting would likely result in lower audit fees than if one auditor is engaged to perform the financial statement audit and another to perform the attestation on internal controls.

6. **Question** – If an "attestation on internal controls" were required of credit unions, should it be required annually or less frequently? Why?

   Response – If an attestation on internal controls were required of credit unions, we believe it should be required annually. Credit unions should be allowed to perform the attestation on internal controls in conjunction with the completion of the financial statement audit for purposes of efficiency.

7. **Question** – If an "attestation on internal controls" were required of credit unions, when should the requirement become effective (i.e., in the fiscal period beginning after December 15 of what year)?

   Response – If an attestation on internal controls were required, credit unions should have at least 24 months from the date the requirement becomes effective. Such a timeline would allow a window to establish the control environment, document performance of controls and implement ongoing monitoring controls prior to implementation of a deadline for the "attestation" per se.

   Although Founders Federal Credit Union believes its controls are currently sufficient to obtain the desirable result from an attestation on internal controls, we believe the timeframe noted above is reasonable because it would allow credit unions facing the attestation requirement sufficient time to respond to the:

   - Financial impact. At Founders, our most conservative projections suggest annualized ROA would be negatively impacted by at least two or three basis points – actual impact on earnings would likely exceed three basis points.
   - Issue of documentation and testing. Feedback from public companies responding to Sarbanes-Oxley provides a vivid picture of this burden (i.e., the financial impact and the demand on company resources is great).

What standards should govern the assessment and attestation components of such an engagement:

8. **Question** – If credit unions were required to obtain an "attestation on internal controls," should part 715 require that those attestations, whether for a natural person or corporate credit union, adhere to the PCAOB's AS 2 standard that applies to public companies, or to the AICPA's revised AT 501 standard that applies to non-public companies? Please explain your preference.

   Response – If credit unions (both natural person and corporate) were required to obtain an attestation on internal controls, they should adhere to the AICPA's revised AT 501 standard. The revised AT 501 is more in line with PCAOB AS 2, which is required for publicly traded companies. The AICPA's standard applies to non-public companies which should accomplish the goal of the NCUA and GAO for improving NCUA's oversight ability and share insurance management as well as creating adequate parity with the requirements of other depository institution regulators. Further, if the PCAOB standard were required, the cost of compliance for credit unions would likely be much higher as it is more stringent than the standard imposed by the AICPA.

9. **Question –** Should NCUA mandate COSO's *Internal Control – Integrated Framework* as the standard all credit union management must follow when establishing, maintaining and assessing the effectiveness of the internal control structure and procedures, or should each credit union have the option to choose its own standard?

Response – A credit union should not have the option to choose its own standard. NCUA should determine the applicable standard to ensure consistency among credit unions. The standard established by NCUA and adopted by credit unions should be based on a comprehensive approach which establishes, maintains and assesses the effectiveness/efficiency of the internal control structure and procedures.

What qualifications should be required as prerequisites to serve on a Supervisory Committee:

10. **Question –** Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have a minimum level of experience or expertise in credit union, banking or other financial matters? If so, what criteria should they be required to meet and what should the minimum asset size threshold be?

    Response – Supervisory Committee members of credit unions, regardless of size, should have some level of experience or expertise in credit union, banking or other financial matters. While such a requirement would negatively impact many credit unions, this experience/expertise is needed by the Supervisory Committee to adequately assess the institutions process, products, services, operating results, etc. Perhaps the essential key when assessing the credit union's asset size, relative to Supervisory Committee experience, is the role Committee members play (i.e., more hands on at smaller institutions and more oversight at larger credit unions).

11. **Question –** Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have access to their own outside counsel? If so, at what minimum asset size threshold?

    Response – It should be a requirement that Supervisory Committee members have access to their own outside legal counsel. Steps should be taken to ensure a relationship (including payment of legal fees) is in place before a need for legal services arises. Such an arrangement would strengthen the Committee's independence. While the Committee should have access to their own legal counsel, they should not be precluded from using the credit union's in-house or retained legal counsel. The Committee should be allowed to weigh each matter on a case-be-case basis and determine how best to resolve the matter. Since asset size has no bearing on potential legal matters, all credit unions, regardless of size, should have access to their own legal counsel. (**Note**: If Supervisory Committee access to its own outside counsel becomes a requirement, NCUA should issue sufficient Committee guidance to ensure the requirement is not misused – for most institutions, a separate Supervisory Committee legal counsel should be used quite infrequently).

12. **Question –** Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be prohibited from being associated with any large customer of the credit union other than its sponsor? If so, at what minimum asset size threshold?

    Response – To be effective, the Supervisory Committee should be independent. In our view, this would include association with any large customer of the credit union other than its sponsor regardless of the credit union's size.

13. **Question –** If any of the qualifications addressed in questions 10, 11 and 12 above were required of Supervisory Committee members, would credit unions have difficulty in recruiting and retaining competent individuals to serve in sufficient numbers? If so, describe the obstacles associated with each qualification.

Response – Of the three questions above (10, 11 and 12), the potential requirements of question 10 would have the greatest negative impact in recruiting and retaining competent individuals to serve in sufficient numbers. Consider the following reasons:

- Many credit unions may lack qualified individuals from their field of membership.
- Many qualified individuals, from within the field of membership, may not be willing to assume the potential liability associated with the position.

Questions 11 and 12 would also have a negative impact in recruiting and retaining competent individuals to serve in sufficient numbers; however, that impact would likely be less significant.

What standard should dictate the degree of independence required of state-licensed, compensated auditors:

14. **Question –** Should a State-licensed, compensated auditor who performs a financial statement audit and/or "internal control attestation" be required to meet just the AICPA's "independence" standards, or should they be required to also meet SEC's "independence" requirements and interpretations? If not both, why not?

    Response – A State-licensed, compensated auditor that performs a financial statement audit and/or internal control attestation should be required to meet only the AICPA's "independence" standards. The standards set forth by the SEC were intended to apply to public companies. Requiring compliance with SEC standards, as pertaining to the issue of auditor independence, would place an unnecessary burden on credit unions and likely have an unnecessary (and negative) impact on audit fees.

Miscellaneous issues involving audit options for credit unions having less than $500 million in assets, requirements for delivery and regulatory access to audit reports, and the terms and conditions in engagement letters, including limitations on auditor liability:

15. **Question –** Is there value in retaining the "balance sheet audit" in existing §715.7(a) as an audit option for credit unions with less than $500 million in assets?

    Response – In general, an annual audit should be performed for credit unions regardless of asset size. The annual audit should be performed by an external auditor meeting the standards set forth by the AICPA and the audit should be conducted in accordance with generally accepted auditing standards. The auditing standards should by applied to the credit union's consolidated statement of financial condition, the related consolidated statements of income, comprehensive income, member's equity, cash flows and accompanying notes for the related years under audit.

16. **Question –** Is there value in retaining the "*Supervisory Committee Guide*" audit in existing §715.7 (c) as an audit option for credit unions with less than $500 million in assets?

    Response – While it is possible for credit unions to obtain value from a Supervisory Committee Guide audit, only the smaller credit unions (i.e., $50 million or less) should be allowed to utilize that option. Except for smaller credit unions, credit union audits should be performed as described in #15 above.

17. **Question –** Should part 715 require credit unions that obtain a financial statement audit and/or an "attestation on internal controls" (whether as required or voluntarily) to forward a copy of the auditor's report to NCUA? If so, how soon after the audit period-end? If not, why not?

    Response – The attestation on internal controls should be reviewed by NCUA during the credit unions' regularly scheduled examination.

18. **Question –** Should part 715 require credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union? If so, how soon after the credit union receives it? If not, why not?

    Response – The management letter should be reviewed by NCUA during the credit unions' regularly scheduled examination.

19. **Question –** If credit unions were required to forward external auditors' reports to NCUA, should part 715 require the auditor to review those reports with the Supervisory Committee before forwarding them to NCUA?

    Response – To ensure proper oversight and fulfillment of their duties, the Supervisory Committee should review the external auditors' report in conjunction with the issuance of the report. This process should be governed by the Committee. Any required report filing with NCUA should be subordinate to the external auditor's review with the Committee.

20. **Question –** Existing part 715 requires a credit union's engagement letter to prescribe a target date of 120 days after the audit period-end for delivery of the audit report. Should this period be extended or shortened? What sanctions should be imposed against a credit union that fails to include the target delivery date within its engagement letter?

    Response – The target date of 120 days appears reasonable. NCUA may consider imposing monetary penalties for late filing unless granted an extension by NCUA. In general, extensions should not be granted by NCUA.

21. **Question –** Should part 715 require credit unions to notify NCUA in writing when they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditor's dismissal or resignation? If so in cases of dismissal or resignation, should the credit union be required to include reasons for the dismissal or resignation?

    Response – External auditor turnover should be reviewed by NCUA during the credit unions' regularly scheduled examination.

22. **Question –** NCUA recently joined in the final *Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters*, 71 FR 6847 (Feb. 9, 2006). Should credit union Supervisory Committees be prohibited by regulation from executing engagement letters that contain language limiting various forms of auditor liability to the credit union? Should Supervisory Committees be prohibited from waiving the auditor's punitive damages liability?

    Response – Limitation of liability provisions can remove or greatly weaken external auditors' objective and unbiased consideration of problems encountered in audit engagements and may diminish auditors' adherence to the standards of objectivity and impartiality required in the performance of Audits. Because the Advisory indicated "appropriate supervisory action" may be taken with respect to unsafe and unsound provisions in external audit engagement letters or related agreements, the Supervisory Committee should be prohibited by regulation from executing engagement letters that contain language (outlined in Appendix A) limiting various forms of auditor liability to the credit union. This should apply to all audit engagement letters (as of February 9, 2006) including voluntary Audits as specified in the advisory. The advisory deems agreements by clients to indemnify their auditors against any third party damage awards, including punitive damages, as unsafe and unsound. Therefore the Supervisory Committee should be prohibited from waiving the auditor's punitive damages liability.

Thank you for seeking credit union input on this important issue. Hopefully, NCUA will find these responses helpful as a final determination is reached.

Sincerely,

Bruce A. Brumfield
President and CEO
Founders Federal Credit Union